

Thirty Years of Economic Freedom

Has the Free Market's Golden Age Come to an End?

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For believers in freedom the last thirty years have been the most exciting in the entire history of mankind. Never before had the march of freedom seemed so irresistible. One dictatorship after another collapsed, the biggest and most brutal tyranny in the world, the “evil empire”, disappeared, inflation rates were reduced everywhere, international trade increased by leaps and bounds, stock markets boomed, regulations and controls were substantially reduced, tax rates went down almost everywhere and a number of countries adopted a flat tax. Arthur Seldon’s prediction in 1980 that the Soviet Union would not last to the end of the 20th century and that China would go capitalist, which at that time seemed like a far-fetched English witticism, proved to be accurate.

To give an idea of how things have changed, think that in the late ‘70s I used to start my course on Monetary Theory at the University of Rome showing a \$20 bill and adding: “this is conclusive evidence that your teacher is a criminal”! At that time in Italy possession of foreign exchange was a criminal offense. In 1980 I moved with my family to spend a sabbatical year in Washington. When we checked into the hotel, the girl at the reception asked for my credit card. When I told her that I did not have one because Italians were not permitted to have a credit card valid outside the country, she said she had to talk to the manager. When she returned she informed me that I could stay only if I paid a week in

advance. I did so, using \$100 bills, and it must have been because of my Italian passport, of those \$100 bills and of the lack of a credit card ... that we've never been treated as well as in that Washington hotel!

The gradual liberalization of international capital movements which took place in the last two decades of the 20th century resulted in an effective mechanism of policy competition, forcing governments all over the world to pursue monetary stability, fiscal prudence, low taxation, deregulation and respect for human rights and liberties. Capital movements have profoundly contributed to changing the world and making policies more compatible with human freedom and economic progress.

The increase in liberty has made amazing progress in science and technology possible. Life expectancy has increased, new medical treatments have been discovered, and an unimaginable progress in communication has taken place. In 1979 we did not have the cell phone, the fax machine, the personal computer and the three Ws did not mean anything. I very much doubt that there has been a comparable thirty year period of progress in the past thousands years.

In the late '70s the United Kingdom was the sick man of Europe, prompting Samuel Brittan to write a paper entitled "How British Is the British Sickness?".¹ Then came Thatcher. In the US, at the end of the '70s the economy was in shambles: the "misery index" (the sum of the inflation and unemployment rates) exceeded 20%. Then came Ronald Reagan.

The Reagan revolution inaugurated one of the longest expansions in the history of the United States, while the success of Mrs. Thatcher's policies was so clear that no Labour government afterward has tried to undo them. We have followed these developments with excitement and enthusiasm: capitalism did indeed work, economic liberty was a potent

¹ *Journal of Law & Economics*, Volume XXI (2), October 1978, 245-268

engine of economic, social, and scientific progress and a very effective promoter of widespread prosperity.

Understandably, believers in big government did not share our enthusiasm. For them the developments of the last thirty years were not a source of joy. Increased freedom in international trade produced undeniable benefits for all countries involved, disproving the case for protection; freer capital movements imposed discipline on all governments of the world; reduction of tax rates promoted growth; all of the arguments of believers in the free market seemed to be undeniably confirmed: a veritable nightmare for our enemies.

It is thus understandable then that they are enjoying the present crisis so much: doesn't it prove the enormous damage done to the world by "unregulated capitalism", the nefarious influence of Hayek, Friedman and the Chicago school? In Italy, but I understand that the same is true in other countries, innumerable newspaper articles and other publications point out the crimes committed by greedy capitalists with the blessing of free market economists, philosophers, and other "reactionary" scholars. All of a sudden Keynes has come back to life, Mussolini's corporate state is enjoying a revival of popularity, and, sooner or later, we'll probably witness Karl Marx's resurrection.

But unreconstructed Keynesians and orphans of Stalin have not been the only ones to draw the wrong conclusions from the crisis. Even supposedly reasonable social democrats have joined the chorus of the "capitalism is dead" crowd. For example, the European commissioner for economic and monetary affairs, Joaquin Almunia, in an article in *The Wall Street Journal*, says: *"While fixing the abundant short-term problems remains the priority, we should not lose sight of the need to lay the foundations for sounder and more responsible global financial and governance systems. If one thing is certain at this stage, it is that what remained of the Thatcher and Reagan ideological heritage -- the aversion to*

any attempt to correct the undesirable effects of the "laissez faire, laissez-aller" approach - has collapsed."

I suspect that Almunia's certainty will meet the same fate as the Marxist prediction of the imminent collapse of capitalism which has failed to materialize in over 150 years. But while I am optimistic about the future of the market, I am also frightened by the probable long term consequences of the policy actions decided all over the world to fight the recession. Almost everywhere these have consisted in increases in government spending, nationalizations and other less traditional forms of expansion in the size of government.

The market is a resilient institution but will it survive this additional burden? Today's increases in government spending almost inevitably will translate themselves into tomorrow's increases in taxation. The trade-off between a dubious, immediate but temporary, advantage and a secondary but long-lasting damage may appear beneficial only to politicians for whom, to use Harold Wilson's felicitous expression, "a fortnight is a long time in politics".

Politicians want public opinion to believe that they are doing everything possible to stem the recession, every other consideration is irrelevant. Tomorrow's problems in many cases will be somebody else's concern, what matters is the present and the immediate future. As Roland Vaubel states in a recent paper ², *"Politicians, like bank managers, are appointed for a limited period of time. Like managers, they have a short time horizon. Yet, they are not paid according to success, nor are they stakeholders, nor is there a political equivalent to bankruptcy."*

² "Lessons from the Financial Crisis: The International Dimension," 15 January 2009

The most urgent task for liberal scholars in my opinion is that of devising some mechanism that can make it in the interest of politicians to care for the long-run, unintended consequences of their policy decisions. But, as long as their perceived interest remains confined to the short-run, individual liberty and economic prosperity will continue to be in danger.

Is the golden age of the market coming to an end? Are we returning to the prevalence of mercantilism, State ownership of industry, central planning, price and income policies, confiscatory taxation, monetary instability and deficit spending? Maybe, but I can't help being optimistic. Throughout human history but especially so in the last thirty years economic liberty has provided ample and sure illustration of its superiority over any other kind of social arrangement. No one, except in Burma and at Harvard University, today believes that there are better alternatives to the free market. Only unadulterated folly can make humanity move in the wrong direction. The market, one of the greatest discoveries of the human race, is here to stay, despite the politicians' attempts to kill it.